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Loss of Credit Capacity and the Economic Damages Associated with Loss of Credit Capacity

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This article examines credit capacity and economic damages from the perspective of forensic economics. Over the last three years, this topic has become a vital topic of discussion, warranting several publications. Constructs related to credit damages are defined, alongside a discussion of future research directions.

Recently, the author has made a cottage industry out of credit damage and interference with credit expectancy with a half-dozen publications in the past three years. **[1-6]**. The blame is not entirely his. There has been a visible absence of any literature on this subject since the first credit damage case in 1844 **[7]**. No analysis of credit damage had appeared in any forensic economic journal until 2011, and then, only from two authors, Stan V. Smith and myself, and then in only one journal **[1,8]**. If any proof were needed of its absence from serious peer-reviewed research, note there is also no reference to either credit damage or credit expectancy damage in the index of any of the twenty-four editions of Gerald Martin's *Determining Economic Damages* **[9]**.

Forensic rehabilitation journals have been more kind to the subject, allowing your author a response to Stan V. Smith's article in its misapplication of the causal factor in credit damage claims, in an introduction to the topic as a new field worthy of peer-reviewed research, and with a seven-item articulation of the manner economic expert witness reports prepared for plaintiffs have gone wrong and been uniformly dismissed by credit damage courts **[1,2,4]**.

What could possibly justify a seventh publication on the topic of credit damage? The answer lies in the fact that like defense which has two kinds of defendants, usually a credit reporting agency or credit granting institution, there are also two kinds of credit damage plaintiffs, and so far my attention has addressed only one.

Credit damage is quantified most often as the differential in interest rates from a credit line or loan that should have been approved at a lower interest rate had it not been for some action(s) on the part of a defendant where this "action" wrongly reduced the individual's credit score. The "action" on the part of the defendant results in either a denial of the credit or a surcharge in the rate of interest charged for credit. Where wrongful disclosure has taken place, said action is deemed an interference with the individual's credit or credit expectancy, and is a compensable tort **[10]**. The same reasoning applies to a shortening of the longevity of the terms of credit and the provision of a lesser dollar volume of credit extended.

Such an approach works fine in circumstances where the damaged party is unaware of the fall in his or her credit rating until such time a credit application is submitted that is either denied outright or an excessive interest rate is charged by the credit-granting institution. Usually, the credit-granting institution cites as the reason for denial or for surcharging a credit report and the poor credit score associated with the credit report.

But there are those individuals who are well aware of the consequences of what major negative events such as home foreclosure and bankruptcy – the two biggest things to avoid in the credit reporting world – can do to a credit score **[10, 11]**. These individuals set out to correct their unfortunate setback by **not** taking credit, and instead righting their course to renewed credit through hard work and cash payments. Unlike the set of individuals described in the prior paragraph, here there is no trail of evidence of credit line and loan applications with either denials or interest rate surcharges to point to as evidence of a plaintiff's loss.

Should a plaintiff chose this second course of action, and not take credit for more than three years, there is no credit transactions to point to in determining credit damage or interference with credit expectancy. Therefore, the quantification cannot, like the usual credit damage case, cite actual loans or actual credit applications either denied or subjected to higher interest rates since no credit applications were submitted. This means the measuring rod for the credit damage cannot be actual loans or actual credit requests but the absence of the plaintiff's ability to transact on normal events of a normal American household having a credit capacity. In this instance, it is not credit surcharges but loss of credit capacity that is inflicted on the plaintiff by the defendant's action.

In the past, owing to its speculative nature, credit capacity has not been an appealing argument to either credit damage courts or your author.

If no loan was applied for, or no identifiable credit capacity, term of loan or interest rate difference is proven, Courts look disfavorably on a "but for" argument .... **[12]**

Even assuming that Smith actually had the capacity to borrow twice his income at the suggested rates ... there was no evidence that Smith tried to or had the intention to borrow anything close to that amount during those five years. The conclusion that Smith should nonetheless be compensated as if he had borrowed the maximum amount of 'available' credit in year one at the high cost of 25% per year is unsupportable. **[13]**

Regardless of the reasonableness of these assumptions about pre and post incident interest rates, the question one must ask is how this method determines a specific loss to "Diane Jones." Since she did not use and apparently did not attempt to use her allegedly lost credit capacity, how can she have suffered a loss equal to the interest on her allegedly lost credit capacity? No attempt is made to explain how this estimated added interest cost for borrowing that did not happen is relevant as a loss to "Diane Jones." **[3]**

Clearly, proof of the amount of lost credit capacity, and proof of interest rate differentials are essential components for bypassing a speculation claim against a damage quantification predicated on credit capacity.

Steps for Measuring Credit Damages

There are four consensus steps for measuring credit damage caused by the actions of a defendant. **[3][8]**

Step 1. Estimate the pre-incident credit capacity of an individual in a gross dollar amount.

The amount of credit capacity used should be grounded in research of the average or median credit of a consumer with income and resources similar to that of a plaintiff. National averages should be employed and weighed against the annual household income of the plaintiff to see if it is an amount lower or higher than the $52,250 annual average for an American household in 2014. **[14]** In this paper, it is assumed that the plaintiff is at the national average

Credit capacity consists of the summation of four different kinds of credit: home or mortgage loans, credit card limits, auto loans, and personal loans such as for home improvement or school loans. Once again, national averages for credit limits for each of these normal credit items must be established for that of a normal American family. **[14][15][16][17][18][19][20]**

Table 1 uses the research from **[14]–[20]** to establish the average consumer consumption against the four different kinds of credit held by a normal American household.

Table 1
Average Consumer Consumption

Damage Item	Avg. Consumer Consumption
Economic—Credit:	
Mortgage Loan	$280,500
Credit Card Debt	$15,593
Auto Loan	$18,258
Person Loan	$10,000
Total Loss On Credit Capacity	**$324,351**

Step 2. Estimate pre-incident and post-incident interest rates for that amount of estimated credit capacity where "incident" relates to the plaintiff's loss.

Table 2 below itemizes the four kinds of credit listed in Table 1 contrasting each line item with the interest rates charged on a consumer with good versus bad credit. To emphasize the difference, in this paper, "good credit" is defined as A or B in a credit ranking from A to G, and bad credit is defined as G, reserved for those having foreclosure and bankruptcy on their credit report. **[14][15][16]**

Step 3. Determine the differential between the estimated pre-incident rate and the estimated post-incident rate.

Table 2 accomplishes this for 2, 4.5, and 7 years, the usual benchmarks for measuring the time it takes for a negative credit event to be removed from an individual's credit report. In the case of foreclosure and bankruptcy, and for purposes of this paper, the number of years for removal is taken as 7 years.

Step 4. Multiply the interest rate differential between the estimated pre-incident rate and the post-incident rate by the estimated pre-incident credit capacity.

At 7 years, the total interest rate differential on a total household credit capacity of $324,351 is $117,993. This is a nominal sum at the date the expert writes the economic damages report. It is an estimate of the interest rate differential in dollar terms that the credit damage tort has inflicted upon a plaintiff's loss of credit capacity. It successfully measures both loss of credit capacity and the interest rate surcharging that would have been experienced had the plaintiff the opportunity of transacting on this credit capacity.

Table 2
Cost of Bad Credit

A	B	C	D	E	F	G	H	I
Damage Item	Avg. Consumer Consumption	Good Credit	Monthly	Bad Credit	Monthly	7 Years	4.5 years	2years
Economic—Credit:								
Mortgage Loan	$280,500	3.00%	$1,182.00	8.75%	$2,206.00	$(86,016)	$(55,296)	$(24,576)
Credit Card Debt	$15,593	11.99%	$155.80	21.99%	$285.74	$(10,915)	$(7,797)	$(3,119)
Auto Loan	$18,258	4.04%	$61.47	14.04%	$213.62	$(12,781)	$(9,129)	$(3,652)
Personal Loan	$10,000	6.03%	$50.25	17.86%	$148.83	$(8,281)	$(5,915)	$(2,366)
Total Loss On Credit Capacity	$324,351					$(117,993)	$(78,137)	$(33,712)
1-Year Projected Inflation Rate (21)						1.0137		
Total Loss On Credit Capacity At Trial Date						$(119,610)		

While this language may sound speculative – we are assigning the plaintiff a credit capacity he does not have but *should* have, and assigning interest rate surcharges that *never* took place —, the speculation claim is muted because the two Tables profile a normal American consumer in a normal American household and the credit this household would be expected to hold and transact upon. To call this speculation is to argue that credit is not employed in American households, or to argue the plaintiff has no right to expect credit of this sort, and that such credit could be rightfully denied him because of a defendant's tort. It is a nonsense argument.

Case Examples

This section is written as an expert witness report for a plaintiff vilified by a credit reporting agency that accepted and transcribed a bank's error of indicating to the agency that this plaintiff was evicted from his home, legally foreclosed upon with a subsequent bankruptcy. All three events never happened. Although there are other economic damages associated with the case, this paper focuses on only credit damages and interference with credit expectancy.

The Plaintiff was current on his mortgage note at the time he was made aware of a wrongful filing from his bank that he had been evicted from the home the mortgage note attached, was foreclosed on by the bank for default in payments on the note, and was currently in the throes of a bankruptcy proceeding. On learning this false information, Plaintiff immediately attempted to resolve the issue with both the bank that had made the wrongful filing and the credit reporting agencies who transcribed the filing onto the plaintiff's credit report. Plaintiff's credit score fell from "Good Credit" or 700 to below 400 or "Bad Credit." After a full year of attempting to rectify the wrongful event, plaintiff sued both his bank (for its wrongful filing) and the credit reporting agency, Experian, for its refusal to acknowledge plaintiff's claim of the wrongful filing. Three years lapsed between the first filing of the wrongful event and the trial date assigned by the court. This expert witness report was written one year prior to trial date so as to meet the discovery deadline.

Plaintiff was financially and emotionally harmed and is requesting financial relief arising from credit damages in the form of "bad credit" and "loss of credit capacity" for a minimum period of three years and no more than seven years from the date of the wrongful filing. The latter number of years is the industry standard for eliminating a foreclosure and bankruptcy from a credit report.

Two Assumptions, One Objective, and One Strategy

Assumption 1. A liability verdict has been determined by the Court in favor of the plaintiffs.

Assumption 2. The credit damages are to be quantified in nominal and trial date dollars as at a trial date of July 1, 2015, or three years after the date of the wrongful filing.

Objective. The end-goal of the quantification is to make plaintiff financially whole from defendant's actions.

Strategy. To accomplish the end-goal for credit damages, three sets of calculations are performed. First, credit capacity is calculated for that of a normal American household with the same household income as plaintiff; second, the nominal surcharge on the credit grade associated with the plaintiff's credit standing

Table 3
Relevant Dates and Events

Date	Description	$	Commentary
07.01.2012	Bank files notice of eviction, foreclosure, and subsequent bankruptcy to credit reporting agency	$280,500	On 1st mortgage with bank even though the plaintiff was current on the note and continued paying on the note throughout the episode of credit damage.
07.01.2013	Plaintiff files 1st Complaint against bank and credit reporting agency	$10,000	A legal construct commencing the lawsuit names the following claims of action: Negligence/Gross Negligence/ Conscious Disregards/Fraud/Malice/Oppression and Special Damages/Breach of Contract/Breach of Fiduciary Duty/Breach of the Covenant of Good Fair Dealing/and Credit Expectancy Damage; Fair Credit Reporting Act is cited as well as state and federal legislation.
01.01.2014	Plaintiff files 2nd Complaint against bank and credit reporting agency	$25,000	A finer parsing of the claims for monetary relief.
07.01.2014	Credit Report from creditscore.com is given to Expert Witness Economist		Shows foreclosure and bankruptcy/no outstanding balances indicate absence of credit capacity.
07.01.2014	Expert Witness Economist files expert witness report		Other economic damages are being quantified by a different expert witness not made part of this report and filed separately with the court.
09.01.2014	Discovery Closes		Both expert witness reports are filed with the Court—damages in trial date dollars.
07.01.2015	Trial Date		3 years from the date of the tort, and 1 year after the filling of the expert witness report.

both before the wrongful filing ("Good Credit") and after the wrongful filing ("Bad Credit") are examined. Loss of credit capacity will be determined from an average consumer credit capacity for the combination of mortgage loan, credit card debt, auto and personal loans **[17][18][19][20]**. Third, adjustment is made to the nominal result with an index that brings the calculation to a value at the estimated trial date of July 1, 2015. **[21]**

1. Damage costs which spread over the three-year period from the date the wrongful filing (July 1, 2012) to the date of trial (July 1, 2015) requires the ability to bring pre-trial date costs forward to the trial date; there are no post-trial date costs to be brought back to trial date.

2. The economic means for moving a stream of damages forward is with an index that increases by one plus the index rate the nominal amount of the credit damages to a trial date.

3. The index rate prices money from one point in time to another; a CPI index is used. **[21]**

Column A itemizes the four main uses of credit in the United States: for buying a home, for buying consumer goods like appliances, for buying a car, and for personal items such as home improvement or school loans. (See Table 2 for each column A through I described here and below.)

Column B uses national averages for the amount of credit each of these categories take from the average consumer. $280,500 for a home loan **[17]**; $15,593 for credit card purchases **[18]**; $18,258 for a car loan(s) **[19]**; and $10,000 for personal loans. **[20]**

Columns C and E are the industry-standard pricing or interest rates for moving from good to bad credit. The plaintiff fell into the latter category owing to foreclosure and bankruptcy on his credit report.

Columns D and F translate the average credit for a category multiplied by the interest rate for credit grade converted into monthly payments.

Columns G, H, and I show the differences between the good and bad credit monthly payments taken out to 2, 4.5, and 7 years.

Since the plaintiff falls into the category of a sincere consumer wanting to earn back his credit standing and capacity, and it is well-known that removal of a foreclosure and bankruptcy takes seven years to cure, the estimate of his credit damages are for seven years. At seven years, the credit damages have a nominal cost to plaintiff of **$117,993.** At trial date, the cost is **$119,610.**

Conclusion

Owing to the wrongful reporting of plaintiff's home foreclosure and bankruptcy by defendant bank and as recorded and transmitted by defendant credit reporting agency, credit capacity of $324,351 was falsely taken from the plaintiff. A downgrading of plaintiff's credit standing increases through bad credit surcharges the interest charged on this credit capacity. The economic damage to the plaintiff is the interest rate differentials multiplied by the credit capacity, a nominal sum of $117,993 needing to be brought to a trial date of July 1, 2015. At July 1, 2015, the economic damages to the plaintiff arising from loss of credit capacity and downgraded credit is **$119,610**.

Expert Witness reserves the right to supplement this report if new information is presented that would make necessary a change to the content of the text and/or tables of the report.[1]

References

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Footnotes

[1] Pain and suffering is not quantified in the expert witness report but would be an added line item of damage at discretion of jurisdiction and plaintiff counsel and to be adjudicated and awarded by the Trier of fact.